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IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1940.**

**No. 740.**

JULIA C. GELFERT, as sole Surviving Executor of the Last Will and Testament of James J. Carpenter, deceased,
*Appellant,*

—against—

THE NATIONAL CITY BANK OF NEW YORK,
*Appellee.*

## *APPELLEE'S BRIEF.*

BARNEY B. FENSTERSTOCK,
*Solicitor for Appellee.*

ZALKIN & COHEN,
*Of Counsel.*

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*Appellant,*

—against—

THE NATIONAL CITY BANK OF NEW YORK,

*Appellee.*

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## *APPELLEE'S BRIEF.*

### *Jurisdiction.*

Certiorari was granted by this Honorable Court on March 3, 1941 (R. 42). Jurisdiction was invoked on the petition for certiorari under Section 237 of the Judicial Code as amended and Section 350 of Title 28, U. S. C. A.

### *Opinions of the Courts Below.*

The opinion of the New York State Court of Appeals is reported in 284 N. Y. 13, 29 N. E. (2d) 449. The opinion of the Appellate Division, Second Department is reported in 257 App. Div. 465 and is found in the record at pages 31 to 37. The memorandum opinion of the Supreme Court, Kings County is found in the record at page 27.

## *Summary Statement of the Case.*

This action was brought by The National City Bank of New York (hereinafter called the "Bank") to foreclose a mortgage made on December 29, 1932 by James J. Carpenter to secure his guaranty of the payment of commercial loans made and to be made by the Bank to Hammond & Carpenter Corporation (R. 20).

On November 15, 1938 judgment of foreclosure and sale was entered fixing the amount due the Bank upon said mortgage at $18,401.25 (R. 5). At the foreclosure sale held on December 16, 1938 the property was purchased by the Bank's nominee for $4,000 (R. 11).

On January 23, 1939 the Bank moved to confirm the referee's report of sale and for a deficiency judgment against the Estate of James J. Carpenter, the appellant herein, in the amount shown by said report, to wit: the sum of $16,162.12 (R. 5-6).

The appellant thereupon made a cross-motion "for an order fixing the real value of the premises foreclosed for the purpose of the deficiency judgment proceedings upon the ground that it would be inequitable and unconscionable to permit the plaintiff herein to enter a deficiency judgment * * * upon the ground that the sale price was wholly inequitable and unconscionable * * *" (R. 19-20).

The Supreme Court, Kings County granted the Bank's motion, confirmed the referee's report of sale, directed a deficiency judgment as shown by that report, and denied appellant's cross-motion (R. 27, 3-4).

On appellant's appeal to the Appellate Division of said Supreme Court, the aforesaid order was modified by striking therefrom the provisions for a deficiency judgment, and as so modified was affirmed (R. 29-30), the Court holding that the amendment to Section 1083 of the New York Civil Practice Act, which became effective

April 7, 1938 (hereinafter called the "new Section 1083"), was applicable to the case at bar and that the Bank had made no application for a deficiency judgment thereunder (R. 31-37).

On the Bank's appeal to the Court of Appeals of the State of New York, the determination of the Appellate Division was reversed and that of the Supreme Court, Kings County reinstated (R. 37-38).

## *Argument.*

## POINT I.

### In the light of the local law, the Court of Appeals correctly held the new Section 1083 to be unconstitutional as applied to the Bank's pre-existing mortgage.

On December 29, 1932 when the mortgage at bar was executed, and thereafter in 1937 when the moneys secured thereby were advanced by the Bank, the law of the State of New York governing the entry of deficiency judgments in foreclosure actions was Section 1083 of the Civil Practice Act, which then read as follows:

> "§1083. JUDGMENT FOR DEFICIENCY. If a person who is liable to the plaintiff for the payment of the debt secured by the mortgage is made a defendant in the action, and has appeared or has been personally served with the summons, the final judgment may award payment by him of the residue of the debt remaining unsatisfied, after a sale of the mortgaged property, and the application of the proceeds, pursuant to the directions contained therein."

Under this statute, as interpreted by the Court of Appeals, liability for a deficiency was finally determined

by the judgment of foreclosure and sale, the subsequent docketing of a deficiency judgment being a merely clerical act; and the measure of such deficiency judgment was the residue of the debt remaining unsatisfied after a sale of the mortgaged property and the application of the proceeds pursuant to the directions of the judgment of foreclosure and sale (*Morris* v. *Morange*, 38 N. Y. 172; *Marshall* v. *Davies*, 78 N. Y. 414, 422; *Wager* v. *Link*, 134 N. Y. 122; *Feiber Realty Corp.* v. *Abel*, 265 N. Y. 94; *Emigrant Industrial Savings Bank* v. *Van Bokkelen*, 269 N. Y. 110).

It is not disputed that the mortgage at bar is unaffected by the New York moratory deficiency judgment act (*New York Civil Practice Act*, §*1083a*) which by its express terms excludes mortgages executed after July 1, 1932.

The new Section 1083 provides that the mortgagee is required to credit on the mortgage debt not the amount actually realized on the foreclosure sale, but a sum which the court determines upon affidavits or otherwise was the fair and reasonable market value of the mortgaged property. By its terms this section applies "in all cases where the sale is held after the date this section as hereby amended takes effect, and in all cases where the sale was held prior to the date this section as hereby amended takes effect and said sale has not theretofore been confirmed".

We respectfully submit that the Court of Appeals correctly held that so far as this new Section 1083 was sought to be applied to the mortgage at bar, which was executed prior to its enactment, it contravened the prohibition of Article I, Section 10 of the Federal Constitution against the passage by a state of legislation impairing the obligation of contracts.

Preliminarily, it should be noted that the new Section 1083 is neither emergency nor temporary legislation (*cf. Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398). It is a permanent statute applicable to foreclosures of all mortgages, regardless of date, amount or parties, and contains no provisions apposite to the relief of any pressing public needs (*cf. W. B. Worthen Co.* v. *Thomas*, 292 U. S. 426). Concurrently with its enactment in 1938, the New York legislature extended the operation of the aforementioned moratory deficiency judgment act until July 1, 1939 (*Laws of 1938, Chap. 501*) and has subsequently further extended such operation to July 1, 1941 (*Laws of 1939, Chap 607*; *Laws of 1940, Chaps. 566, 567*). In the light of these circumstances, the Court of Appeals in the case at bar has found as a fact that the new Section 1083 is not addressed to the general welfare of the state, but is directed solely to the private contractual rights of parties to an indebtedness secured by a mortgage on real property (*cf. Veix* v. *Sixth Ward Association*, 310 U. S. 32).

This Honorable Court has consistently held that the law which provides a remedy for the enforcement of a contract, as that law exists at the time of the making of the contract, enters into and becomes part of such contract as if fully set forth therein (*Farmers Bank* v. *Federal Reserve Bank*, 262 U. S. 649; *Bronson* v. *Kinzie*, 1 How. 311), and that subsequent legislation may not constitutionally change such remedy in any material respect, at least unless a substantially co-extensive remedy remains or is furnished thereby (*Edwards* v. *Kearzey*, 96 U. S. 595; *McCracken* v. *Hayward*, 2 How. 608, 612; *Oshkosh Water Works Co.* v. *Oshkosh*, 187 U. S. 437, 439; *Home Building & Loan Ass'n.* v. *Blaisdell*, 290 U. S. 398, 434).

In *McCracken* v. *Hayward, supra,* this Honorable Court stated this principle as follows (p. 612):

> "* * * The obligation of a contract consists in its binding force on the party who makes it. This depends on the laws in existence when it is made; these are necessarily referred to in all contracts, and forming a part of them as the measure of the obligation to perform them by the one party, and the right acquired by the other. * * * If any subsequent law affect to diminish the duty, or to impair the right, it necessarily bears on the obligation of the contract, in favor of one party, to the injury of the other; hence any law, which in its operation amounts to a denial or obstruction of the rights accruing by a contract, though professing to act only on the remedy, is directly obnoxious to the prohibition of the Constitution."

The direct application of these principles to statutory remedies for the enforcement of mortgages has been particularly noted by this Honorable Court.

*Clark* v. *Reynolds,* 8 Wall. 318, 322.

That the new Section 1083 makes material and substantial changes in the previously existing system of foreclosure, as the Court of Appeals has held herein, is undeniable. It changes the essential nature and purpose of a foreclosure proceeding from a method whereby a creditor might obtain a liquidation of his security and thereupon apply on his debt the amount of cash actually received, to a means whereby the debtor may obtain a valuation of the security by opinion evidence and thereupon force the creditor to apply the amount of such valuation on the debt, regardless of the price which said security had brought on the actual sale and regardless of whether

the creditor or a third person had bid it in. The provisions of the new section neither require nor permit consideration of any equitable factors or of the relative circumstances of the parties, but compel every mortgagee in every situation to bid in the property in foreclosure at a price at least equal to the valuation which may thereafter be fixed by the court or to forego satisfaction of so much of the mortgage debt as equals the difference between the value so fixed and a lower price bid on a sale to a third party.

Applied to pre-existing contracts, therefore, the practical effect of the new Section 1083 is to change the medium of payment agreed upon by the parties from lawful money of the United States to a parcel of real property. Nor is the debtor required to pay "money's worth" in such real property, for he must be credited on his debt with the amount of a hypothetical valuation of such property, regardless of whether the creditor ever actually realizes that amount thereon.

In this connection it should be observed that while the very fact of the foreclosure at bar presumably imports the inability of the mortgaged property to earn sufficient to carry itself under the normal conditions which the new Section 1083, as permanent legislation, presupposes, no provision is made in said section for reimbursing the Bank for such losses as it may sustain in maintaining the property until the time it realizes thereon the "determined market value", assuming that that time eventually arrives—a factor of direct, practical significance to the Bank which, as a national bank, is prohibited by statute from holding property thus acquired for a longer period than five years (*44 Stat. 1227, Chap. 191, Section 3, U. S. C. A. Title 12, Section 29*).

Likewise indisputable is the finding of the Court of Appeals in the case at bar that no remedy substantially equivalent to that afforded by the old Section 1083 remains to the mortgagee under the local law. The right to recover the mortgage debt at law, apart from the mortgage security, is circumscribed by a statutory prohibition against the levy of execution on the mortgagor's equity of redemption (*New York Civil Practice Act, §710*). The maintenance of a second action, after foreclosure, to recover a deficiency resulting from the foreclosure sale is prohibited by statute except by leave of the court (*New York Civil Practice Act, §1078*), but settled authority is against the granting of such leave in respect of a party who could have been made a defendant in the foreclosure action unless special circumstances are shown manifestly requiring that relief (*Equitable Life Assurance Society* v. *Stevens*, 63 N. Y. 341; *Scofield* v. *Doscher*, 72 N. Y. 491; *Vanderbilt* v. *Schreyer*, 91 N. Y. 392; *Morrison* v. *Slater*, 128 App. Div. 467; *Darmstadt* v. *Manson*, 144 App. Div. 249; *Stehl* v. *Uris*, 210 App. Div. 444). Whether the new Section 1083 has superseded Section 1078 so as to forbid the granting of such leave in any case was left open by the Court of Appeals in its opinion at bar, but some indication was given that such a holding was not improbable (see *Honeyman* v. *Hanan*, 275 N. Y. 382, 392).

State statutes similar in purpose and effect to the new Section 1083 have in the past been held unconstitutional by this Honorable Court in so far as they were sought to be applied to contracts in existence at the time of their enactment.

*Bronson* v. *Kinzie*, 1 How. 311;
*McCracken* v. *Hayward*, 2 How. 608;
*Gantly's Lessee* v. *Ewing*, 3 How. 707.

In *McCracken* v. *Hayward, supra*, the invalidated statute provided that no execution sale could be held unless the

property to be sold would bring two-thirds of its value according to the opinion of three householders.

In *Gantly's Lessee* v. *Ewing, supra,* a statute of the State of Indiana prohibiting foreclosure sales for less than one-half the appraised value of the property was held unconstitutional, this Honorable Court saying (pp. 716-717):

> "The contract of mortgage was a vested interest, and its main incident a right to have the land applied in discharge of the debt, either by an execution executed, as on a judgment at law, or in some form of remedy substantially equal. The new remedy, prescribed by the Act of 1341, changed the contract and required among other things that the mortgaged premises should not be sold to satisfy the debt unless they were first valued and one-half of that value was bid for them. If the legislature could make this alteration in the contract, and in the decree enforcing it, so it could declare the property should bring its entire value, or that it should not be sold at all; thereby impairing, or defeating the obligation under the disguise of regulating the remedy. This court held in *Bronson* v. *Kinzie,* 1 How. 319, that the right, and a remedy substantially in accordance with the right, were equally parts of the contract, secured by the laws of the state where it was made; and that a change of these laws, imposing conditions and restrictions on the mortgagee, in the enforcement of his contract, and which affected its substance, impaired the obligation, and could not prevail; as an act directly prohibited, could not be done indirectly."

At the October, 1937 Term, this Honorable Court denied certiorari in a case in which the Supreme Court of South Carolina had held unconstitutional the retroactive applica-

tion of a statute virtually identical with the new Section 1083.

*Jefferies* v. *Federal Land Bank*, 302 U. S. 708.

In recent years numerous state courts of last resort have voided similar statutes as applied retroactively.

*Bontag* v. *McCurdy*, 59 Pac. (2d) 326 (Ariz.);
*Adams* v. *Spillyards*, 61 S. W. (2d) 686 (Ark.);
*Hales* v. *Snowden*, 65 Pac. (2d) 847 (Cal.);
*Atlantic Loan Co.* v. *Peterson*, 181 Ga. 266;
*Vanderbilt* v. *Brunton Piano Co.*, 111 N. J. L. 596;
*Federal Land Bank* v. *Garrison*, 193 S. E. 308 (S. C.), cert. denied *sub nom. Jefferies* v. *Federal Land Bank, supra*;
*Langever* v. *Miller*, 76 S. W. (2) 1025 (Tex.).

The case of *Honeyman* v. *Jacobs*, 306 U. S. 539, on which the appellant relies, is plainly distinguishable from the case at bar. First, the statute under consideration in the *Honeyman* case (*Section 1083a of the New York Civil Practice Act*) was moratory legislation, occasioned by a pressing public emergency legislatively declared, and was, by express limitations of both scope and duration, specifically adapted to the relief of that emergency. The vital distinctions between such an enactment and the permanent legislation here involved have heretofore been observed by this Honorable Court (*W. B. Worthen Co.* v. *Thomas*, 292 U. S. 426; *Worthen Co.* v. *Kavanaugh*, 295 U. S. 56). Second, the value of the property in the *Honeyman* case was found "without question" to be equal to the mortgage debt. There is no such concession in the case at bar and even the appellant's evidence indicates the contrary (R. 22-24 and see Point II, *infra*).

In so far as the opinion of this Honorable Court in the *Honeyman* case may have indicated that the validity of the act there considered was sustainable, apart from the existent emergency, on the ground that it merely codified a power which courts of equity in New York have always possessed to control the measure of deficiency judgments in foreclosure actions, we respectfully submit that the Court of Appeals, in an unbroken line of decisions from earliest times to the case at bar, has held that no such equitable jurisdiction in foreclosure suits ever existed or now exists, apart from statute, in the State of New York.

*Morris* v. *Morange*, 38 N. Y. 172;
*Wager* v. *Link*, 134 N. Y. 122;
*Frank* v. *Davis*, 137 N. Y. 275;
*Feiber Realty Corp.* v. *Abel*, 265 N. Y. 94;
*Emigrant Industrial Savings Bank* v. *Van Bokkelen*, 269 N. Y. 110;
*Guaranteed Title & Mortgage Co.* v. *Scheffres*, 275 N. Y. 30.

Historically, the lack of such power traces back to the days when courts of law and courts of equity were separate and the jurisdiction of the equity court in a foreclosure action ceased when the foreclosure sale was confirmed, the creditor being obliged to resort to a separate action at law for any deficiency judgment. The following excerpt from the opinion of Chief Judge Earl of the Court of Appeals in *Frank* v. *Davis*, 135 N. Y. 275, 277-8, summarizes the matter succinctly:

> "In England, and in this state prior to the Revised Statutes, the Court of Chancery, in an action to foreclose a mortgage, was not supposed to have jurisdiction to render a personal judgment against the mort-

> gagor upon his bond or covenant to pay the mortgage debt, and such a judgment could only be obtained by an action at law. (*Noonan* v. *Lee*, 2 Black 499, 501; *Orchard* v. *Hughes*, 1 Wall. 73; *Dunkley* v. *Van Buren*, 3 Johns. Ch. 330; *Jones* v. *Conde*, 6 id. 77; *Globe Ins. Co.* v. *Lansing*, 5 Cow. 380; *Sprague* v. *Jones*, 9 Paige 252; *Equitable Life Ins. Socy.* v. *Stevens*, 63 N. Y. 341, 344; *Burroughs* v. *Tostevan*, 75 N. Y. 567, 572.) This was an exception to the general rule, that where a court of equity obtains jurisdiction of an action it will retain it and administer full relief, both legal and equitable, so far as it pertains to the same transaction or the same subject-matter (*Lynch* v. *Elevated Railroad Co.*, 129 N. Y. 274; *McGean* v. *The Same*, recently decided in this court [133 N. Y. 9])."

The decisions of the New York Appellate Division, an intermediate appellate court, in *Monaghan* v. *May*, 242 App. Div. 64 and *Guaranteed Title & Mortgage Co.* v. *Scheffres*, 247 App. Div. 294, have both been overruled by the Court of Appeals. In *Emigrant Industrial Savings Bank* v. *Van Bokkelen*, 269 N. Y. 110, the Court of Appeals said of the former case (p. 116):

> "Perhaps it should be said that we do not approve the decision in *Monaghan* v. *May* (*supra*)."

In the latter case (*Guaranteed Title & Mortgage Co.* v. *Scheffres*), on appeal from the final order (275 N. Y. 30), the Court of Appeals reversed the order of the Appellate Division which had affirmed the order of the Special Term entered pursuant to the earlier decision in 247 App. Div. 294 and reinstated the deficiency judgment previously granted to the plaintiff.

In the case at bar, the Court of Appeals, after reconsideration, has again rejected the doctrine of *Monaghan* v. *May*, and has reaffirmed its previous declarations that equity courts in New York possess no inherent power to

control the measure of deficiency judgments in foreclosure actions.

Of course, equity courts have always had and still have power to refuse confirmation of foreclosure sales where equitable grounds, *i. e.*, fraud, collusion, inadequacy of price so gross as to shock the conscience of the court, etc., are present and affirmatively established,* but in any such case the only relief which the court could grant the mortgagor would be to order a resale. The Court of Appeals in *Emigrant Industrial Savings Bank* v. *Van Bokkelen*, 269 N. Y. 110, has stated the proposition thus (p. 115):

> "The court had an undoubted discretion within limits to refuse confirmation of the report of sale, or to open the sale made to the plaintiff bank under the judgment, and in either case to order a resale. (*Brown* v. *Frost*, 10 Paige 243; *Crane* v. *Stiger*, 58 N. Y. 625; *Hale* v. *Clauson*, 60 N. Y. 339; *Fisher* v. *Hersey*, 78 N. Y. 387.)"

In respect of all of the foregoing matters of local law, the pronouncements of the Court of Appeals are, we submit, controlling and conclusive upon this Honorable Court.

*Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64;
*Ruhlin* v. *New York Life Insurance Co.*, 304 U. S. 202.

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* No such equitable grounds are present in the case at bar: no fraud or collusion was ever claimed, and although appellant asserted in its cross-motion that "the sale price was wholly inequitable and unconscionable", no appeal was taken by it from the Appellate Division's affirmance of the denial of said cross-motion by the Supreme Court, Kings County. The appellate courts below have found that the price was not shockingly inadequate and that no likelihood of any greater realization on a resale had been shown (257 App. Div. at 467; 284 N. Y. at 15). In fact the price represented the fair and reasonable market value of the property (see Point II, *infra*).

The case of *Richmond Mortgage & Loan Corp.* v. *Wachovia Bank & Trust Co.*, 300 U. S. 124, is not, as appellant asserts, contrary to the instant decision, but is entirely reconcilable therewith. In the cited case, this Honorable Court held that a North Carolina statute, which applied only where the sale was by a trustee under a power of sale in the mortgage deed and only where the mortgagee was the purchaser at such sale, did not impair the obligation of contract because the remedy of strict foreclosure in equity which remained to the mortgagee was substantially co-extensive with the remedy affected by the statute. The governing principle of this decision is unquestioned, but its application to the case at bar leads to the opposite result in view of the inequivalence and inadequacy of the remaining remedies afforded by the law of New York as construed by the Court of Appeals.

The decision at bar is sustainable upon a further ground. At the time the mortgage herein was made and at the time the moneys secured thereby were advanced, mortgages executed on and after July 1, 1932 were, by express statutory exception, excluded from the coverage of the moratory deficiency judgment act (*Laws of 1933, Chap. 794, Sec. 4*). The stimulation of business by the encouragement of new loans was an integral part of the legislative policy in dealing with the then existing emergency. In effect, therefore, there was direct legislative assurance to lenders that loans secured by mortgages made after July 1, 1932 would be enforceable in the manner provided by the then Section 1083, *i. e.*, with deficiency judgments for the full residue of the debt, and the parties at bar must be deemed to have contracted in reliance upon that legislative assurance. While this assurance may not have the full contractual force of the government bonds involved in the "Gold Clause" cases, there is sufficient analogy in the legislative attempt, by the new Section

1083, to revoke its pledge retroactively, to give appreciable aptness to the following language of this Honorable Court in one of said cases, *Perry* v. *United States,* 294 U. S. 330, 351:

> "By virtue of the power to borrow money '*on the credit of the United States*', the Congress is authorized to pledge that credit as an assurance of payment as stipulated,—as the highest assurance the Government can give, its plighted faith. To say that the Congress may withdraw or ignore that pledge, is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government."

An even closer analogy is found in the case of *Home Owners Loan Corp.* v. *Robinson,* 285 N. W. 768 (Wis.), where a mortgage moratorium statute contained a section expressly exempting federal agencies from its operation. While this exemption was in effect, a mortgage loan was made by the plaintiff, a federal agency. Thereafter the exemption section was repealed. In the subsequent foreclosure suit, the Supreme Court of Wisconsin overruled the defendant's contention that the moratorium statute was applicable, holding that the legislature could not, by such repeal, retroactively revoke an exemption which had existed when the mortgage was made.

Upon all of the foregoing grounds and in the light of the local law as conclusively interpreted, we respectfully submit that the Court of Appeals was correct in holding that the new Section 1083, in its application to the mortgage at bar, is a clear violation of the mandatory restriction embodied in Section 10 of Article I of the Federal Constitution and is therefore void.

Upon the same analysis and for the same reasons the new Section 1083, as applied to the mortgage at bar, is violative of Section 6 of Article I of the Constitution of the State of New York and is also invalid thereunder.

*Sliosberg* v. *New York Life Insurance Co.*, 217 App. Div. 67, 72, affd. 244 N. Y. 482;
*People ex rel.* v. *Otis*, 90 N. Y. 48, 52a.

## POINT II.

**The judgment appealed from is entirely sustainable, apart from the constitutional question.**

Assuming, *arguendo*, that the new Section 1083 may constitutionally be applied to the mortgage at bar, the proceedings in the Supreme Court, Kings County were, as a matter of local practice, a compliance with the requirements of said section sufficient, even under the dissenting opinion of Judge Lewis of the Court of Appeals, to constitute an application for a judgment thereunder.

Considering the facts and circumstances at bar as upon such an application, the judgment appealed from, we submit, represents a proper exercise of the discretion vested in the court by the new Section 1083 to award a deficiency judgment for "the whole residue, or so much thereof as the court may determine to be just and equitable, of the debt remaining unsatisfied * * *".

The Bank is a national bank engaged in a commercial banking business. The loans secured by the guaranty of the appellant's testator, which was in turn secured by the mortgage at bar, were ordinary commercial loans to a business corporation. They were not advances made on the security of real estate and neither by the agreement

of the parties nor by any reasonable construction of their transaction was real estate to be the primary source of repayment. It would be neither "just" nor "equitable" to compel the Bank to credit upon the indebtedness thus incurred an amount in excess of the actual proceeds of the foreclosure sale of the property which, at most, was secondary security. In fact, any such requirement would be contrary to the public interest in the stability and liquidity of banks (see *Rothschild* v. *Manufacturers Trust Co.*, 279 N. Y. 355, 359-361). The Bank could not have agreed at the inception of the transaction to accept land in repayment, for that would have been, in effect, an agreement to purchase real property, which is prohibited by the National Banking Act (*44 Stat. 1277, Chap. 191, Sec. 3; U. S. C. A. Title 12, Sec. 29*). The public policy underlying this statute is the desirability of keeping the capital of banks liquid and of preventing the accumulation of real estate in their hands (*National Bank* v. *Matthew*, 98 U. S. 621, 626), and it would be a manifest frustration of that policy to permit a borrower to convert his obligation to repay his loan in cash into a right to repay it with real estate merely because the bank had taken a mortgage as additional security.

Nor is the instant decision unjust or inequitable to the appellant. The situation at bar does not involve the intervention of an unforeseen economic catastrophe between the date the obligation was incurred and the time for its repayment. The debt at bar was contracted in 1937 and was to be repaid within a short time. The same general economic conditions prevailed throughout this period.

On the other hand the reliance of the Bank upon the aforementioned legislative assurance that the enforcement of this loan would be governed by the old Section 1083 would abundantly warrant the favorable exercise of the discretion vested in the court to award a judgment that is "just and equitable".

Apart from all other considerations, moreover, the judgment appealed from is entirely sustainable on the ground that the price realized at the foreclosure sale represented, as a matter of fact, the fair and reasonable market value of the premises at the time of such sale.

The essential facts concerning the mortgaged property are not in dispute. The premises are approximately 25 x 100 feet and are located at 38th Street and 4th Avenue, Brooklyn, New York. They are improved with a two story brick building containing a cellar, a store and dwelling quarters for one family, with two garages. It was estimated by both parties that (after reserving $100, approximately 8% of the gross rental value, for vacancies), the property will produce a gross annual income of $1100 (R. 26). The out-of-pocket operating expenses are $441 for taxes, $50 for insurance, $20 for water, and $100 for repairs and supplies, making a total of $611 (R. 26), and leaving a net annual income of $489, without considering any reserve for depreciation, taxes other than real estate taxes, expenses for collecting rents, supervision of building, etc.

Based on an estimated net annual income of approximately $500, Harold M. Mills, a real estate expert, in an affidavit submitted by the Bank on the proceedings in the Supreme Court, Kings County (R. 25-27), appraised the property at $6,500. If this estimated net annual income be reduced by a suitable amount for the aforementioned reserves and the appraisal commensurately decreased, a valuation of $4,000 becomes entirely fair and reasonable.

No sound measure of value may be predicated upon the fact that the premises were assessed for tax purposes at $15,000. On this assessment the tax is $441, which is more than 40% of the estimated gross annual income and more than 70% of the total expenses of the property. Clearly, therefore, this assessment is excessive and, as

Mr. Mills pointed out, is a serious factor in depressing the market value of the property (R. 27).

Finally, the fact that the National City Realty Company offered the property for sale at $6,500 (R. 27) is tangible confirmation that the bid of $4,000 actually represented the fair and reasonable market value of said property. With the deduction from the offering price usually necessary to conclude a bargain, and with broker's commissions and other expenses of sale, the realization of more than $4,000 net on a sale based on such initial offering price is doubtful.

We respectfully submit, therefore, that the Bank was properly adjudged by the Supreme Court, Kings County to be entitled to a deficiency judgment for the full residue of the debt and that said judgment is entirely sustainable, apart from the constitutional question, on that ground.

## CONCLUSION.

**The judgment appealed from should be affirmed.**

Respectfully submitted,

BARNEY B. FENSTERSTOCK,
*Solicitor for Appellee.*

ZALKIN & COHEN,
*Of Counsel.*

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# SUPREME COURT OF THE UNITED STATES.

No. 740.—October Term, 1940.

Julia C. Gelfert, as Sole Surviving Executor of the Last Will and Testament of James J. Carpenter, Deceased, Petitioner,
*vs.*
National City Bank of New York.

On Writ of Certiorari to the Supreme Court of the State of New York.

[April 28, 1941.]

Mr. Justice Douglas delivered the opinion of the Court.

This action was brought by respondent to foreclose a mortgage made in December, 1932, by Carpenter. At that time § 1083 of the New York Civil Practice Act provided that the amount of the deficiency judgment was to be measured by the residue of the debt remaining unsatisfied after a sale of the mortgaged property and the application of the proceeds pursuant to the directions contained in the judgment. In November, 1938, a judgment of foreclosure and sale was entered for $18,401.25, and in December, 1938, the foreclosure sale was held at which the property was purchased by respondent's nominee for $4,000. The referee, appointed by the court to sell, reported a deficiency which after the inclusion of taxes, fees and expenses was computed at $16,162.12. Respondent moved to confirm the referee's report of sale and asked that a deficiency judgment be entered for that amount. Petitioner took exceptions to the report and made a cross-motion to have the court fix the value of the property for the purpose of determining the amount of the deficiency judgment on the ground that the sale price was "wholly inequitable and unconscionable". A new § 1083[1] (L.

[1] That section provides:

"Judgment for deficiency; limitation. If a person who is liable to the plaintiff for the payment of the debt secured by the mortgage is made a defendant in the action, and has appeared or has been personally served with the summons, the final judgment may award payment by him of the whole residue, or so much thereof as the court may determine to be just and equitable, of the debt remaining unsatisfied, after a sale of the mortgaged property and the application of the proceeds, pursuant to the directions con-

1938, ch. 510), effective April 7, 1938, provides in substance that the court in determining the amount of a deficiency judgment should, on appropriate motion, "determine, upon affidavit or otherwise as it shall direct, the fair and reasonable market value of the mortgaged premises" and should deduct from the amount of the debt the "market value as determined by the court or the sale price of the property whichever shall be the higher." The right to recover any deficiency is made dependent on the making of such a motion. The court denied petitioner's cross-motion[2] and directed the entry of a deficiency judgment for $16,162.12. The judgment of the Appellate Division denying respondent a deficiency judgment because it had not made a motion for one under the new § 1083 (257 App. Div. 465, 13 N. Y. S. (2d) 600), was reversed by the Court of Ap-

tained in such judgment, the amount thereof to be determined by the court as herein provided. Simultaneously with the making of a motion for an order confirming the sale provided such motion is made within ninety days after the date of the consummation of the sale by the delivery of the proper deed of conveyance to the purchaser in all cases where the sale is held after the date this section as hereby amended takes effect, and in all cases where the sale was held prior to the date this section as hereby amended takes effect and said sale has not heretofore been confirmed, then within ninety days from the date this section as hereby amended takes effect or within ninety days after the date of the consummation of the sale by delivery of the proper deed of conveyance to the purchaser, regardless of whether the sale was held prior or subsequent to or on the date this section as hereby amended takes effect, the party to whom such residue shall be owing may make a motion in the action for leave to enter a deficiency judgment upon notice to the party against whom such judgment is sought or the attorney who shall have appeared for such party in such action. Such notice shall be served personally or in such other manner as the court may direct. Upon such motion the court, whether or not the respondent appears, shall determine, upon affidavit or otherwise as it shall direct, the fair and reasonable market value of the mortgaged premises as of the date such premises were bid in at auction or such nearest earlier date as there shall have been any market value thereof and shall make an order directing the entry of a deficiency judgment. Such deficiency judgment shall be for an amount equal to the sum of the amount owing by the party liable as determined by the judgment with interest, plus the amount owing on all prior liens and encumbrances with interest, plus costs and disbursements of the action including the referee's fee and disbursements, less the market value as determined by the court or the sale price of the property whichever shall be the higher. If no motion for a deficiency judgment shall be made as herein prescribed the proceeds of the sale regardless of amount shall be deemed to be in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist. . . ."

[2] An affidavit of a real estate broker submitted by petitioner in support of his cross-motion stated that in his opinion the fair market value of the property was $11,000. An affidavit of an appraiser submitted by respondent in opposition stated that in his view the fair market value of the property was $6,500. The property was assessed by New York City for tax purposes at $15,000.

peals which held, one judge dissenting, that the new § 1083 as applied to mortgage contracts previously made violated the contract clause of the Federal Constitution. 284 N. Y. 13, 29 N. E. (2d) 449. We granted the petition for certiorari because of the important constitutional question which was raised.

As noted by the Court of Appeals the measure of a deficiency under the new § 1083 is in substance the same as that prescribed by the New York moratory deficiency judgment act—§ 1083-a of the Civil Practice Act. The latter section was sustained by this Court under the contract clause of the Federal Constitution in *Honeyman* v. *Jacobs*, 306 U. S. 539. But the Court of Appeals said that the new § 1083, unlike the moratory deficiency judgment act, is not addressed to a declared public emergency, is unrestricted in its application,[3] "concerns merely the private contract relationship of the parties to a real property mortgage," is not "designed for the relief of urgent public needs," is not "conditioned upon any equitable factor," leaves "no room for the play of any equitable consideration," benefits "every mortgagor irrespective of the character or amount of his investment," and burdens "every mortgagee no matter what his necessities". The Court pointed out that under previously existing statutes of New York the liability for a deficiency was to be finally determined by a judgment of foreclosure and sale, that the "subsequent docketing of a deficiency judgment was a merely clerical act", and that the deficiency was to be ascertained by a sale and "not by the estimates of witnesses or other less satisfactory evidence". It held that that system of foreclosure "entered into the engagement of the present parties and created and defined the legal and equitable obligations of their contract". It also pointed out that unlike the situation in *Richmond Mortgage & Loan Corp.* v. *Wachovia Bank & Trust Co.*, 300 U. S. 124, there remained under the laws of New York no remedy available to the mortgagee which was "substantially coextensive" with that afforded by the old § 1083, since, though an action at law for the debt might lie, the judgment debtor's equity of redemption could not be sold under an execution upon that judgment and since the right to bring a second action to recover a deficiency resulting on a foreclosure sale, if it existed at all under the new legislation, was dras-

[3] The moratory deficiency judgment act did not apply to mortgages or connected agreements dated on or after July 1, 1932. See 284 N. Y. 13, 16-17.

tically restricted. Accordingly, it held that in light of such cases as *Barnitz* v. *Beverly*, 163 U. S. 118, the new § 1083 could not be applied to mortgage contracts previously made without violation of the contract clause of the Federal Constitution.

We take a different view.[4]

The formula which a legislature may adopt for determining the amount of a deficiency judgment is not fixed and invariable. That which exists at the date of the execution of the mortgage does not become so embedded in the contract between the parties, that it cannot be constitutionally altered. As this Court said in *Home Building & Loan Assn.* v. *Blaisdell*, 290 U. S. 398, 435, "Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order." And see *Voeller* v. *Neilston Warehouse Co.*, 312 U. S. —. It is that reserved legislative power with which we are here concerned.

The control of judicial sales of realty by courts of equity and by legislatures in order to prevent sacrificial prices has a long history. Weiner, Conflicting Functions of the Upset Price, 27 Col. L. Rev. 132, 133, *et seq.* In chancery sales in England during the eighteenth century there developed the practice of opening the bidding, prior to confirmation, on an offer to advance the price 10 per cent. *Graffam* v. *Burgess*, 117 U. S. 180, 191. That practice, much criticized by Lord Eldon, was gradually supplanted by reserved bidding —in the first instance by equity (*Jervoise* v. *Clarke*, 1 Jac. & W. 388) and subsequently by statute. Sale of Land by Auction Act, 1867, 30 & 31 Vict. c. 48, § 7; *Graffam* v. *Burgess, supra*, p. 191; 1 Daniell, Chancery Practice (7th ed. 1901) pp. 879-880. Though the early English rule of advance bidding found little foothold in this country, reserved bidding has its counterpart here in the occasional utilization by equity courts of the upset price in mortgage foreclosures. *Blair* v. *St. Louis, H. & K. R. Co.*, 25 Fed. 232; *Pewabic Mining Co.* v. *Mason*, 145 U. S. 349; 2 Bonbright, Valuation of Property, pp. 849, *et seq.*; Stetson *et al.*, Some Legal Phases of Corporate Financing, Reorganization and Regulation (1927), p.

[4] We are concerned here solely with the application of this statute to a situation where the mortgagee purchases the property at foreclosure sale. We intimate no opinion on its constitutionality as applied to the case where the mortgagee is not the purchaser.

202. And it is quite uniformly the rule in this country, as in England, that while equity will not set aside a sale for mere inadequacy of price,[5] it will do so if the inadequacy is so great as to shock the conscience or if there are additional circumstances against its fairness, such as chilled bidding. *Cocks* v. *Izard*, 7 Wall. 559; *Graffam* v. *Burgess, supra; Ballentyne* v. *Smith*, 205 U. S. 285. Beyond that, a number of states by statute have endeavored to prevent property going for a song at judicial sales. Provisions that the property shall not be sold at less than a designated percentage of its appraised value, and requirements that a stated percentage of the appraised value above the sales price must be credited on the debt are illustrative. 3 Jones, Mortgages (8th ed. 1928) §§ 1695 *et seq.;* 2 Bonbright, Valuation of Property, pp. 839 *et seq.*

We mention these matters here because they indicate that for about two centuries there has been a rather continuous effort either through general rule or by appeal to the chancellor in specific cases to prevent the machinery of judicial sales from becoming an instrument of oppression. And so far as mortgage foreclosures are concerned numerous devices have been employed to safeguard mortgagors from sales which will or may result in mortgagees collecting more than their due. The variety of formulae which has been employed to that end is ample evidence not only of the intrusion which advanced notions of fairness have made on the earlier concern for stability of judicial sales but also of the flexibility of the standards of fairness themselves. Underlying that change has been the realization that the price which property commands at a forced sale may be hardly even a rough measure of its value. The paralysis of real estate markets during periods of depression, the wide discrepancy between the money value of property to the mortgagee and the cash price which that property would receive at a forced sale, the fact that the price realized at such a sale may be a far cry from the price at which the property would be sold to a willing buyer by a willing seller reflect the considerations which have motivated departures from the theory that competitive bidding in this field amply protects the debtor.

[5] But see Suring State Bank v. Giese, 210 Wis. 489; Wilson v. Fouke, 188 Ark. 811; Teachers' Retirement Fund Ass'n v. Pirie, 150 Ore. 435.

Mortgagees are constitutionally entitled to no more than payment in full.[6] *Honeyman* v. *Jacobs, supra.* They cannot be heard to complain on constitutional grounds if the legislature takes steps to see to it that they get no more than that. As we have seen, equity will intervene in individual cases where it is palpably apparent that gross unfairness is imminent. That is the law of New York. 284 N. Y. 13, 20. And see *Fisher* v. *Hersey,* 78 N. Y. 387. But there is no constitutional reason why in lieu of the more restricted control by a court of equity the legislature cannot substitute a uniform comprehensive rule designed to reduce or to avoid in the run of cases the chance that the mortgagee will be paid more than once. Cf. *Suring State Bank* v. *Giese,* 210 Wis. 489. Certainly under this statute it cannot be said that more than that was attempted. The "fair and reasonable market value" of the property has an obvious and direct relevancy to a determination of the amount of the mortgagee's prospective loss. In a given case the application of a specified criterion of value may not result in a determination of actual loss with mathematical certitude. But "incidental individual inequality" is not fatal. *Phelps* v. *Board of Education,* 300 U. S. 319, 324. The fact that men will differ in opinion as to the adequacy of any particular yardstick of value emphasizes that the appropriateness of any one formula is peculiarly a matter for legislative determination. Certainly, so far as mortgagees are concerned, the use of the criterion of "fair and reasonable market value" in cases where they obtain the property for a lesser amount holds promise of tempering the extremes of both inflated and depressed market prices. And so far as mortgagors are concerned, it offers some assurance that they will not be saddled with more than the amount of their obligations. To hold that mortgagees are entitled under the contract clause to retain the advantages of a forced sale would be to dignify into a constitutionally protected property right their chance to get more than the amount of their contracts. *Honeyman* v. *Jacobs, supra.* The contract clause does not protect such a strategical, procedural advantage.

In conclusion, the statute in question, like the one involved in *Richmond Mortgage & Loan Corp.* v. *Wachovia Bank & Trust Co.,*

[6] As to the bankruptcy power see Wright v. Union Central Life Ins. Co., 311 U. S. 273, and cases cited.

*supra*, p. 130, "cannot fairly be said to do more than restrict the mortgagee to that for which he contracted, namely, payment in full." Here, as in that case, the obligation of the mortgagee's contract is recognized; the statute does no more than limit "that right so as to prevent his obtaining more than his due." *Id.*, p. 130. To be sure, the mortgagee retained in that case an alternative remedy while in the instant one the Court of Appeals has said that under New York law there remained no alternative remedy "substantially coextensive" with that which had been removed. But it is clear from *Honeyman* v. *Hanan*, 302 U. S. 375, that a requirement that the right to a deficiency judgment should be determined in the foreclosure proceeding or that a mortgagee is not entitled to a deficiency judgment unless he moves for one raises no substantial federal question. As stated by this Court in that case (302 U. S. at p. 378), the Federal Constitution does not prevent the states from determining, on due notice and opportunity to be heard, "by what process legal rights may be asserted or legal obligations" enforced. The principles of those cases are applicable here. The fact that an emergency was not declared to exist when this statute was passed does not bring within the protective scope of the contract clause rights which were denied such protection in *Honeyman* v. *Jacobs, supra.* See *Home Building & Loan Assn.* v. *Blaisdell, supra.*

Respondent points out that earlier decisions of this Court have struck down under the contract clause, as respects contracts previously made, a state statute requiring judicial sales to bring two-thirds of the amount of the appraised value of the property. *Bronson* v. *Kinzie*, 1 How. 311; *McCracken* v. *Hayward*, 2 How. 608. And see *Gantly's Lessee* v. *Ewing*, 3 How. 707. Those cases, however, have been confined to the special circumstances there involved. *Home Building & Loan Assn.* v. *Blaisdell, supra*, pp. 431-434. We cannot permit the broad language which those early decisions employed to force legislatures to be blind to the lessons which another century has taught.

The judgment is reversed and the cause is remanded to the New York Supreme Court for proceedings not inconsistent with this opinion.

*It is so ordered.*